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A WHITE PAPER ON

GROWTH MANAGEMENT AND CITY REVENUE SHARING

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GROWTH MANAGEMENT AND CITY REVENUE SHARING

Purpose of the Report

Over the last several years there have been various proposals introduced by the State Legislature regarding growth management and regional governments. In addition, for a number of years several organizations in the San Francisco Bay Area have suggested the importance of some form of regional government in order to appropriately manage growth and the regional effects of growth. Some proponents of regional government have also suggested revenue sharing amongst cities as a key ingredient to make growth management work. Additionally, the Governor's Office of Planning Research is currently exploring the issue of growth management and the "fiscalization" of land use.

The attached report, titled "Revenue Sharing at the City Level in California," describes the complexities of revenue sharing at the local level and details the uniqueness of each city government and each community and the reasons why it is difficult to establish proxy measures, based on revenue generation, of either the need for revenue sharing or the relationship between revenue generation and growth management. This report will not repeat that information although certain key aspects will again be highlighted.

It is a generally held fact that cities pursue certain forms of development not only for the purpose of creating a balance within the community, but also for revenue generating purposes. It is not the purpose of this report to study or assess whether this generally held "fact" can be substantiated. That would require a specialized study of the policies, intent and level of knowledge in each city regarding the relationship between a particular form of development and the revenues and expenditures which relate to that development. Rather, it is the purpose of this report to explore those revenue sources which, at least on the surface, would seem to be related to growth; to compare various levels of revenue generation in cities within this case study (Santa Clara County cities); to detect how various combinations of revenue sources which on the surface may seem to be related to growth when combined in various combinations result in substantially different conclusions; and, to briefly discuss how each selected revenue source may or may not be related to the question of growth management.

Data Sources and Study Approach

Five sources of local revenue were selected for purpose of this study. They were chosen for one of two reasons -- either because they are commonly referenced in any discussion of revenue sharing for growth management purposes or because they clearly seem as (or more) relevant to the issue of growth and revenues than those which are commonly addressed.

The five revenue sources selected for this analysis are sales tax, a city's allocation of the one percent property tax excluding bonded indebtedness, that portion of the one percent

provides services usually provided by municipal government, tax increment revenues produced by individual city redevelopment agencies, and business license taxes.

The information contained in this report was derived from the Departments of Finance of the County of Santa Clara and various individual cities' finance departments for Fiscal Year 90/91.

Population figures for each city, used as a part of this analysis, were derived from the California Department of Finance demographic research unit for the calendar year beginning January l, 1991. Information relating to the number of jobs within each community was derived from the Association of Bay Area Government's Projection 90 for the year 1990.[1]

It is recognized that some of this information may not be entirely accurate. In each case, however, the most current and generally used source of information was selected for this study. More important, for the purposes of this report are the fundamental questions of the relationship between revenue generation and growth and the complexity of deriving a formula regarding revenues which can be shown to be reasonably related to the issue of growth and be equitable, without counterproductive and unintended consequences.

Revenue Sources

Sales Tax

Statistical Information

Illustration I depicts the sales tax revenue generated on a per capita basis for each Santa Clara County city. The range varies from $9 per capita to $266 per capita. As also can be seen in the illustration, there is a substantial difference between the per capita yield for the various communities. In other words, the low and the high end of the range are not reflecting statistical quirks, but rather the per capita amount is highly variable.

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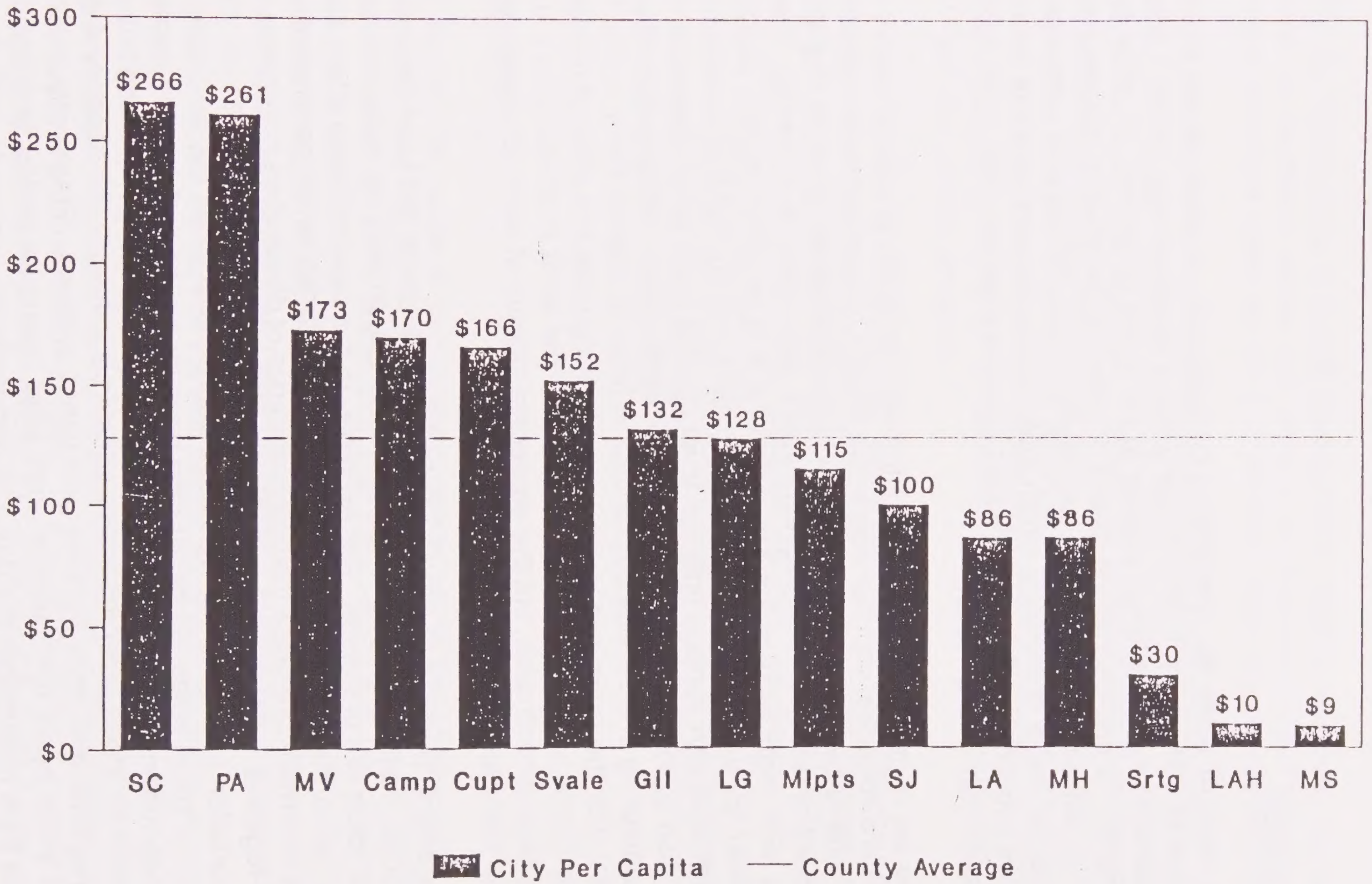
[1]The abbreviations in the following illustrations are coded as follows: Mountain View (MV), Milpitas (Mlpts), Santa Clara (SC), Palo Alto (PA), Campbell (Camp), Cupertino (Cupt), Sunnyvale (Svale), Gilroy (Gil), Los Gatos (LG), San Jose (SJ), Los Altos (LA), Morgan Hill (MH), Saratoga (Srtg), Los Altos Hills (LAH) and Monte Sereno (MS).

ILLUSTRATION 1
SALES TAX PER CAPITA



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Discussion

The issue of sales tax revenues is complex and, as seen above, highly variable. In the context of this report, however, the issue is whether sales tax as a measure is a good or reasonable measure when related to the issue of growth. In order to assess this, it is necessary to understand the nature of sales tax generating business and industry and to also review other revenue sources related to growth for those same communities in order to assure that a community which looks either low or high when sales tax is measured follows suit with other growth related revenue sources. This latter point will be explored in detail later in this report.

Sales tax is generated essentially through the lease or sale of goods at the retail level. As a consequence, communities which tend to have reasonably high sales tax generation also tend to be the communities that house businesses such as regional malls and large numbers of retail businesses, restaurants, auto sales, and the like. More often than not, cities with high retail sales tax yields have substantial central districts. Retail uses, however, by their very nature, do not induce growth, but rather respond to it. A defined market area can support only the level of retail sales which the economy in that market area can generate. Therefore, retail sales follow housing growth, non-retail sales manufacturing and service businesses in order to support them, rather than creating that growth. For the most part, sales tax generating uses in a defined market are going to be in one community or another based upon the local land use policy of encouraging or discouraging such uses, but the aggregate amount of sales for a defined market area will remain constant.

As important, businesses which generate sales tax do not have the employment nor the land consumption of business activities which provide no sales tax proceeds, or very limited sales tax proceeds. For example, in the case of Santa Clara County it is clearly office, research and development and manufacturing which generate the preponderance of jobs and therefore place the preponderance of demand on the various service systems, local, regional and state. In fact, those uses place pressures on systems such as transportation to a far more significant degree than sales tax producing uses. The vast majority of retail sales tax generating uses do not have the same peak demand effects on transportation systems as do office, service, and manufacturing industries. The trips generated by those latter industries effectively influence the capacity designs needed for local, regional and state highway and transit systems. Frequently, retail establishments do not even open for business until after commute peaks are completed, and then produce trips throughout the day and frequently on weekends and other off peak hours. Transportation, of course, is only one example of the growth management concern, although it is one of the most important and also has a direct relationship to air quality

issues, another significant issue of growth management. Clearly, however, non-sales tax generating uses as described above also have a far more significant effect on water systems, sewage treatment systems, and the like than sales tax generating uses.

Another factor to consider is the individual land use policies of particular cities. Although clearly there is competition between various cities for sales tax generating uses, competition does not have any necessary relationship to the growth management issue as demonstrated above, nor is it necessarily bad. However, the land use policies and desires of a particular community do have a significant relationship. Some desire to host sales tax generating uses. Others do not. When local land use policies and desires are factored in, it becomes clear that many of the communities have low sales tax proceeds as a result of their own policy decisions.

In summary, there appears to be no strong, reasonable relationship between sales tax proceeds and legitimate growth management issues. If a sharing arrangement were mandated and the revenue source was sales tax, the primary beneficiaries would be Monte Sereno, Los Altos Hills, Saratoga, Morgan Hill and Los Altos. Most of these communities have income levels well above county norms and have often substantial zoning restrictions on the type and amount of commercial development permitted. Under this scenario, they would gain because they have chosen to severely limit certain land uses otherwise needed in any urban area.

Property Tax

<u>Statistical Information</u>

Illustration 2 depicts the range of per capita property tax in the communities studied. Similar to sales tax, there is a considerable range between communities in terms of their per capita yield. It is important to understand that the difference in per capita yield has three variables. The first variable is the differential assessed value per capita of each community. Those that are largely bedroom communities naturally have a substantially lower assessed value per capita than those that have a substantial commercial base.

The second variable is the percent of the one percent property tax which is apportioned to a particular city. Often people believe that the cities are the primary recipients of property taxes. That was not the case prior to Proposition 13 nor is it subsequently the case. Prior to Proposition 13, each community established its local levy based upon their local revenue needs and their local taxing policy. The pre-Proposition 13 percent of a city government's property tax revenue was frozen by action of the State Legislature as a means to assure that the constitutional requirement of the one percent limit could be implemented. Therefore, as shown on Table 1 there is a considerable range between cities as to the percent of the total property tax levy which they receive and communities

ILLUSTRATION 2
CITY PROPERTY TAX PER CAPITA

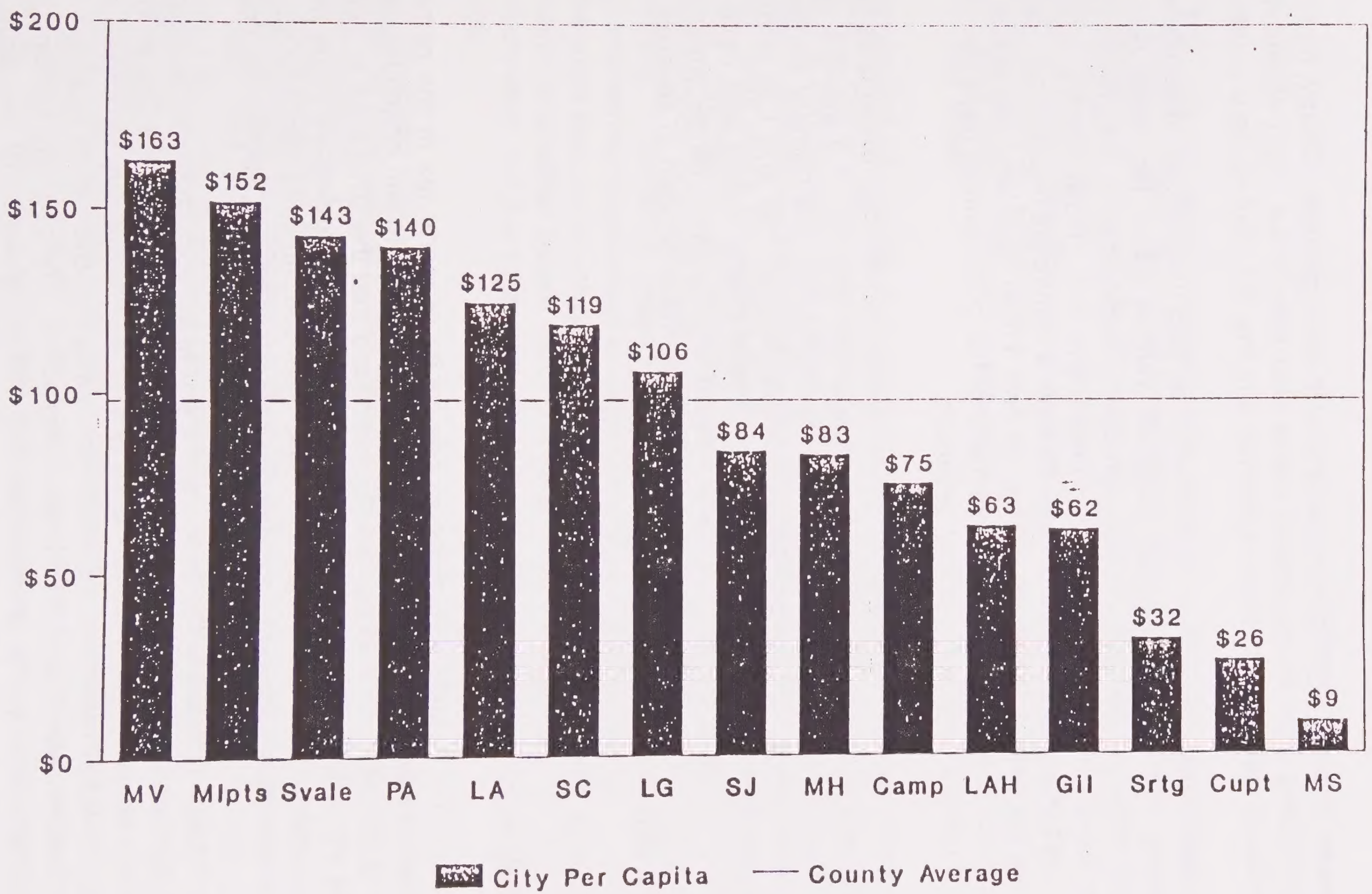

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TABLE 1

Percent of 1% Property Tax Apportioned to Cities

Campbell	Los Altos	Milpitas	Mountain View	Santa Clara
13%	14%	18%	20%	3%
Cupertino	Los Altos Hills	Monte Sereno	Palo Alto	SARATOGA ~~San Jose~~
2%	5%	1%	12%	3%
Gilroy	Los Gatos	Morgan Hill	San Jose	Sunnyvale
13%	12%	14%	21%	16%

with identical per capita assessed value may in fact have different per capita property tax collections as a result.

The third variable relates to whether a community has chosen to be a full service municipality or not. Some Santa Clara County cities (as is the case throughout California) do not provide fire services or library services, as an example. This means that those communities do not have to support those particular services through their city budgets and as a result generally have a substantially lower pre-Proposition 13 tax rate, and thus today a low property tax yield.

Discussion

Similar to sales tax there is a wide range of per capita property tax proceeds. Generally, communities with large commercial bases have higher per capita yields than those who, as a matter of land use policy, have minimized the amount of office, industrial and other commercial space.

Because the property tax applies to all privately held property, there would appear to be a far stronger relationship between the property tax and growth management concerns than is the case with sales tax. Detailed study would likely reveal that the linkage is **not** as strong as it might appear on the surface. First, as again depicted in Table 1, cities do not receive the preponderance of property tax as may commonly be believed. If a city received 15 percent of the property tax on a particular piece of property then a property with $1 million assessed value would yield $10,000 in property taxes with only $1,500 of that amount going into city coffers. While it is debatable whether or not the public services demanded as a result of that $1 million development would exceed or be less than revenue yield, it is clear that the net proceeds are not nearly as great as some would suspect.

The issue, of course, is whether the property tax, as an individual and independent measure, is a good proxy to be used for any growth management program. While more directly related than sales tax, its low yield suggests that it, as an independent measure, would not be a sound one. Illustration 2 depicts some interesting results. Two of the six lowest communities on a property tax basis are among the top five on a sales tax basis. Therefore on one scale these same communities would be considered growth inducing and on another deserving of revenue assistance. Some may argue that both sources should be added together to get a clearer picture. To do so, however, only clouds the issue of fiscalization of land use. A community cannot be both growth generating and not growth generating at the same time. This reinforces the fact that neither measure truly distinguishes communities whose growth policies may negatively affect a sub-region or region from those who do not.

Special Districts

Statistical Information

Illustration 3 demonstrates the per capita property tax yields of special districts which provide municipal services. In Santa Clara County only two services provided by special districts were selected, those being library services and fire services. Within Santa Clara County, library services are either provided by municipal government or through a special district. These special districts receive a portion of the one percent property tax. As can be seen in the illustration, the range is again a very wide one -- from zero dollars per capita to $285 per capita. Those who have no per capita yield from special districts tend to be full service cities and always are cities that directly provide, through their own tax base, fire and library services.

It is important to understand that cities do not directly fund nor directly operate these special districts. However, it is possible to derive from the total property tax revenue coming out of a particular city the portion which is attributable to a special district serving that city and therefore to derive a per capita number.

Discussion

The range of per capita property tax for special district purposes is larger than that for either the sales tax or general property tax. It is no surprise in reviewing the results that often communities that have a very low per capita property tax have a very high per capita property tax for special district purposes. In fact, for five of the ten communities that are served by either a fire district or library district or both, per capita property tax yield is above the average property tax yield for communities that are not served by special districts. This is without adding the cities' own property tax share in the computation! Illustration 4 overlays per capita property tax collected for each city in Santa Clara County with the special district property tax collected. It reveals substantial change in relationship in the city's portion of property tax.

This combination again confuses the relationship between property tax and growth. Clearly, only by combining a city's property tax with a special district's property tax providing municipal services can an equitable and "apples to apples" comparison be made. As this comparison clearly shows, it is frequently not cities with substantial commercial bases that have the highest per capita levy and it is difficult to ascertain how any conclusion can be drawn as to how a system can be put together which has the desired growth management outcome. In many cases it would clearly result in

ILLUSTRATION 3

SPECIAL DISTRICT (FIRE & LIBRARY) PROPERTY TAX PER CAPITA

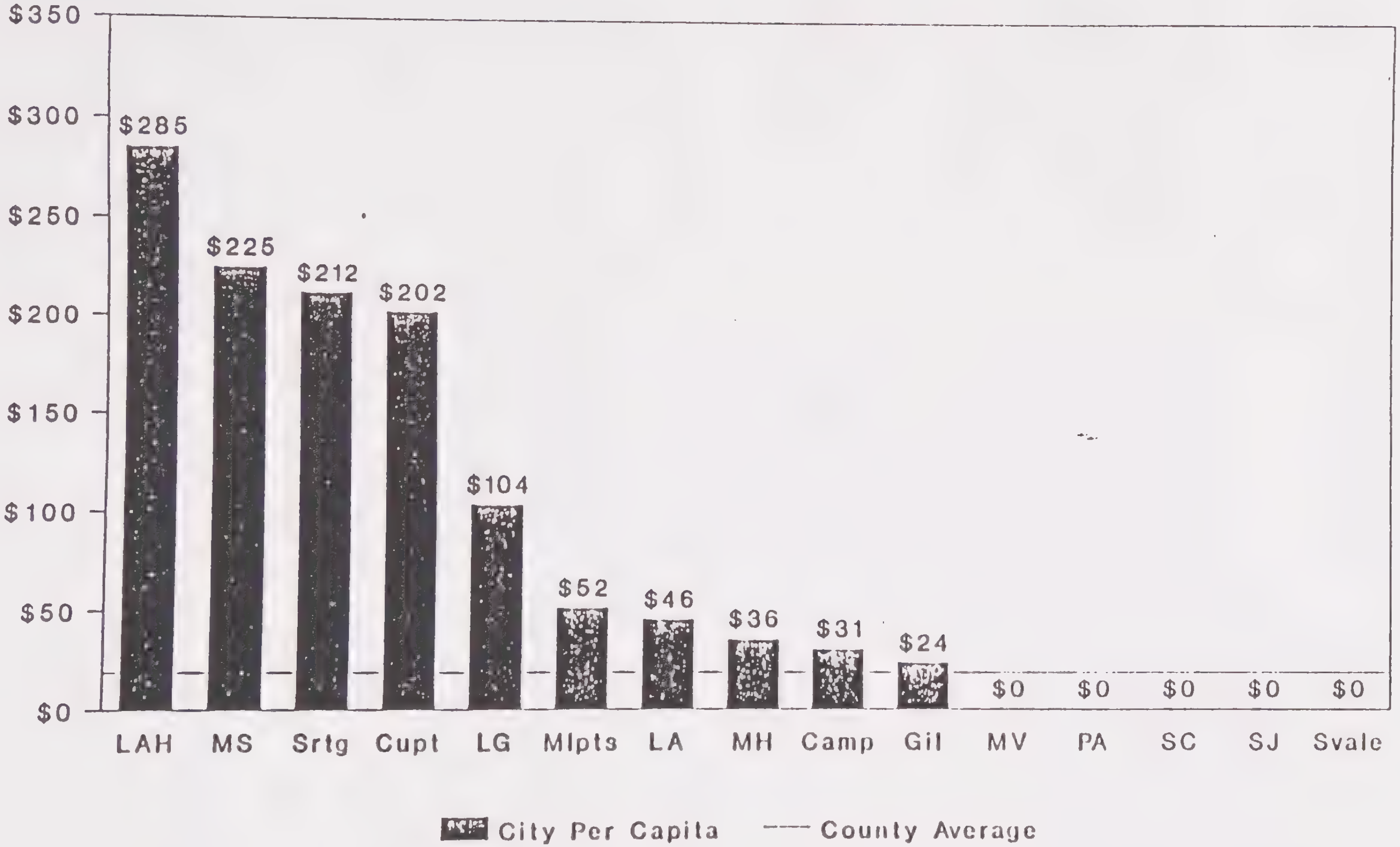

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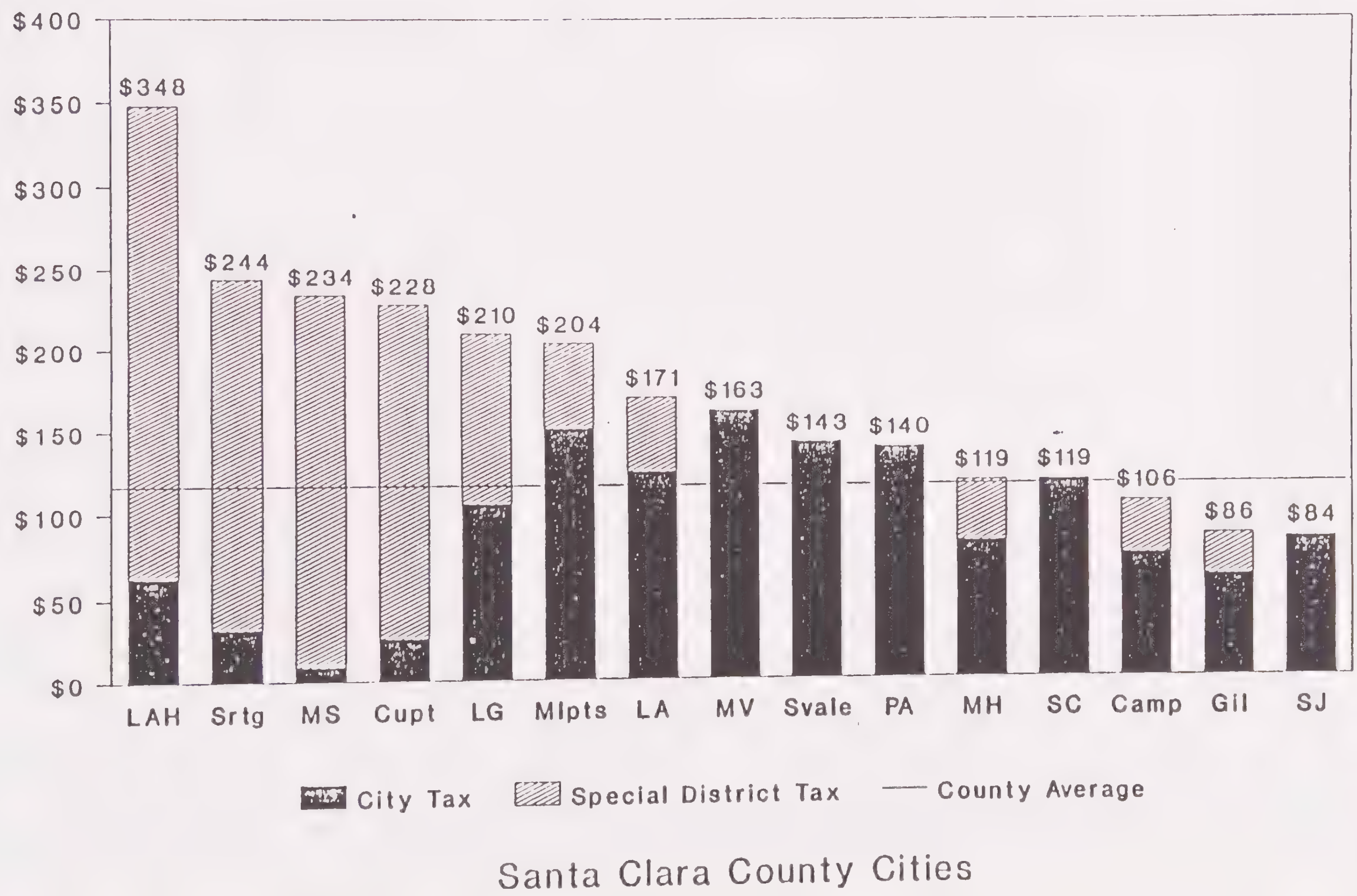
ILLUSTRATION 4

CITY & SPECIAL DISTRICT (FIRE & LIBRARY) PROPERTY TAX PER CAPITA



Special Dist Augmenta tin funds, funds allocated to Sp. dist after Prop 13

communities who have chosen to have few, if any, job producing uses ensuring revenue to those communities which may have aggressive growth policies.

Redevelopment Revenue

Statistical Information

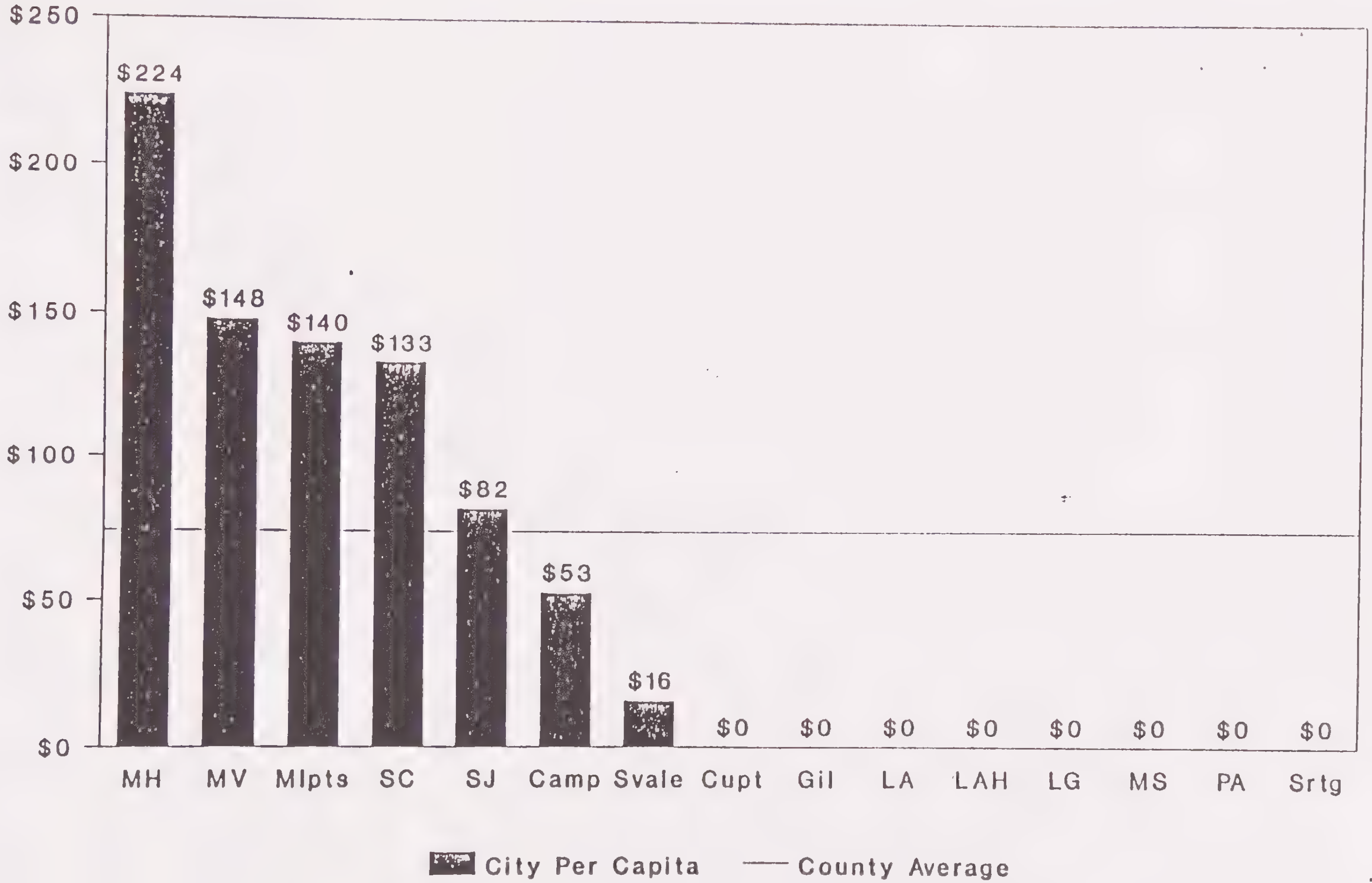
Illustration 5 provides information regarding the per capita revenue yield in each of the various cities for redevelopment agencies. Redevelopment revenue is essentially property tax revenue provided on a tax increment basis. That means that all incremental assessed value growth after a redevelopment project is established goes to the respective city's redevelopment agency for allowable purposes they choose to pursue. Unlike cities' appropriation of the one percent property tax which in all cases is a small proportion of the overall property tax, redevelopment agencies receive 100% of the revenue of property tax growth. Range varies from no revenue per capita for those cities who do not have redevelopment agencies to $223 per capita.

Discussion

Redevelopment revenue is a difficult one to address given the fact that its use is far more limited than other sources of revenue to cities. It can be, however, and frequently is used to undertake many projects which otherwise would have to be supported by the general fund of a particular community. It is used to build roads and interchanges, utility systems, and specialized cultural and art facilities.

In reviewing the revenue producing impacts of redevelopment, it would appear to clearly be the case that it is by far the most growth inducing source of revenue of those under review. First, when $1 million of new assessed value is present a full $10,000 in property tax reverts to that city's redevelopment agency, not the $1,500 described in the earlier example in the property tax section. This means that there is a far more powerful financial incentive to encourage growth in redevelopment areas. Second, redevelopment revenue is frequently used to support the development of businesses which in turn yield additional revenues back to a particular city's general fund. Frequently, redevelopment revenues are used for purposes of assisting in the development of sales tax generating uses as well as uses that provide other major revenue streams to a city, such as transient occupancy taxes, business taxes, and utility users taxes. Therefore, although redevelopment revenues cannot be used, and are not used, to support many general municipal services, they are used as a replacement in many cases for expenditure items that in other cities are supported by the general fund and they do frequently, as a consequence, contribute substantially to the generation of new tax dollars from other city tax sources. They, by their very nature and purpose, are growth inducing.

ILLUSTRATION 5
REDEVELOPMENT TAX INCREMENT PER CAPITA



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This analysis is not to suggest redevelopment revenues on a per capita basis are a good method to gauge and manage growth, only to suggest that it is clearly the most growth inducing of the sources of revenue reviewed. If redevelopment revenue were the source selected for sharing, again a new set of haves and have nots would result.

Another interesting way to look at redevelopment revenue is to determine how much property tax would flow to a city if an agency did not exist. For example, San Jose receives $84 in per capita property tax (Illustration 2). As noted in Table 1, their share of 1% property tax collected is 21%. Their proceeds from redevelopment is $82 per capita. If the redevelopment agency did not exist, San Jose's share of the $82 would be $17 per capita. Added to their existing $84 per capita, San Jose's per capita collection would become $101 per capita or the average for the county.

Finally, redevelopment agencies have a significant effect on a city's own property tax collection. If significant areas in a particular city are in redevelopment areas, that city's general property tax growth rate will be less than without one. Again, San Jose presents a good example. San Jose's yield for redevelopment income is literally identical to the city-wide property tax. Because so much revenue is captured by redevelopment it sharply reduces the growth to that city of general property tax. None of the growth in a redevelopment zone goes to that city's general property tax. Therefore, per capita sharing of property taxes becomes biased in favor of major growth inducing activities and against those who do not pursue redevelopment -- even though those redevelopment prone cities see 100% property tax revenues under the auspices of their redevelopment agencies. Not only does this result in double jeopardy and a highly inequitable circumstance, but as important, it rewards unrestricted growth.

Business License Taxes

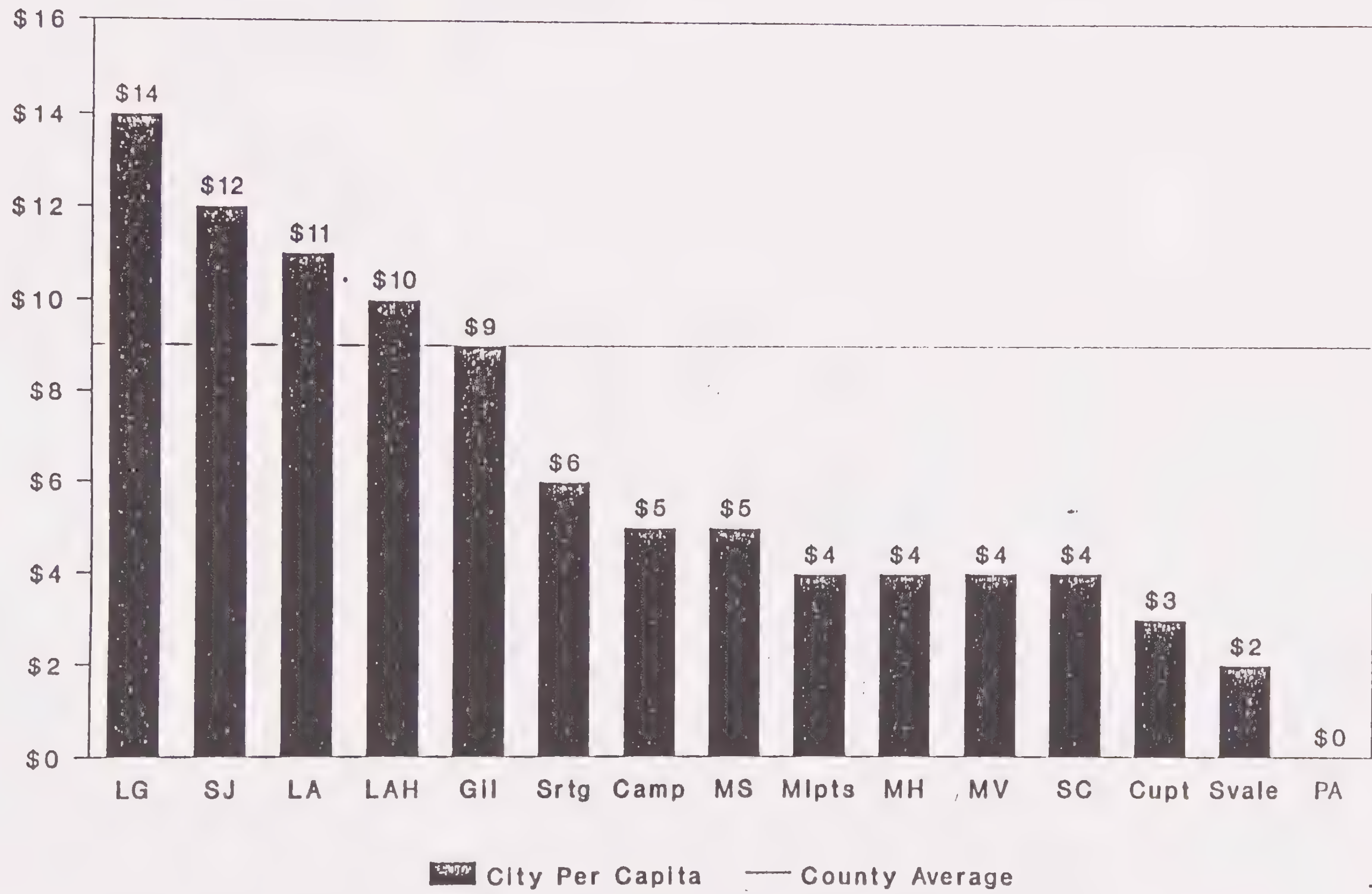
Statistical Information

As once again can be seen in Illustration 6, there is a wide range of per capita revenue yield from business taxes. Some communities have literally none and others have a large per capita yield. Frequently, communities who have small or no business tax yield are again the communities who have chosen not to host large business elements, but that is not consistently the case.

Discussion

On the surface, business taxes would seem to be an excellent measure for growth management purposes. It is clear, however, that although sizable revenues can be generated from business taxes, they have as much to do with the individual tax policies of a particular community as they have to do with the amount of job generating uses.

ILLUSTRATION 6
BUSINESS LICENSE TAX PER CAPITA



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Some communities with very high levels of commerce and industry have reasonably low per capita yields. As an independent measure to be used for growth management strategies, business license taxes are not likely to be good ones although they may be a reasonable consideration when aggregating various sources together.

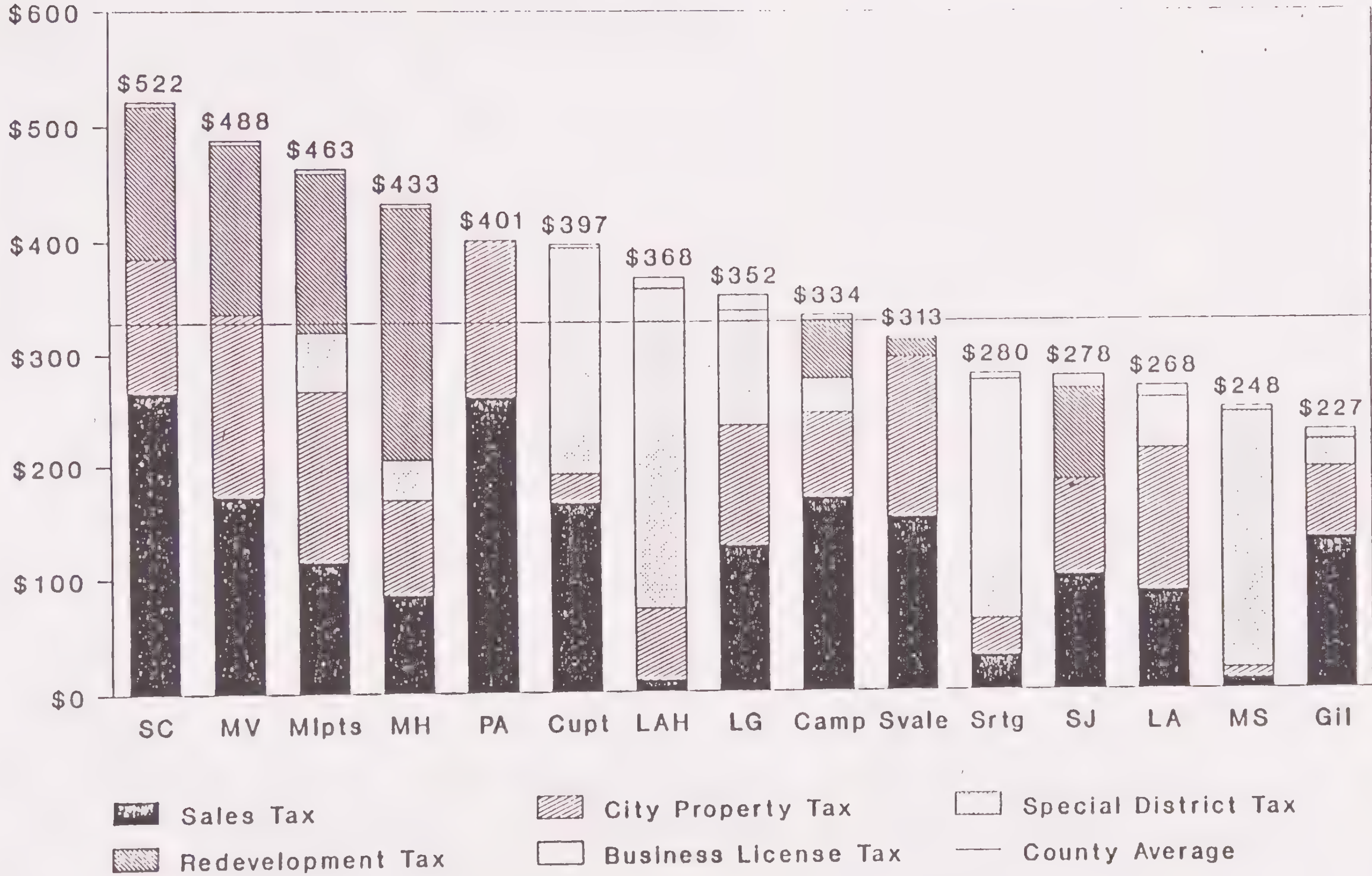
Analysis

As described in the attached revenue sharing report, differences between community makeup, community need, and community policy at a city level vary to extraordinary proportions. Any determination that local revenue sharing should in some fashion occur does bring into question the paramount local government concerns of local control of tax policy and local control over land use. Because of the prevalent belief on the part of many that revenues dictate many land use policies and in turn those land use policies place pressure or costs on regional and state systems, the issue of revenue sharing has been raised. As noted in the introduction of this report, it is not the premise of this report to challenge that decisions are to a certain extent dictated based on revenue and expenditure consequences. No business nor any level of government would take action without these factors playing at least some role in the decision. When addressing the issue of revenue sharing for growth management purposes, a number of questions must be addressed. A first, and paramount, question is whether a particular source of revenue is sufficiently directly tied to a behavior outcome that it would in fact have the consequences intended, namely more rational growth management control. The second question is whether a system can be devised which is equitable, fair, and reasonable and not have unintended consequences. The third question to be addressed is whether the intrusion into local affairs justifies the result, particularly if other devices can be developed which have a far more significant and profound effect on the basic issues of growth management.

The individual preceding illustrations show the dramatic changes that could occur and who are the winners and losers of revenue sharing based on the revenue source which is selected. It clearly demonstrates that, depending upon the sources or combination of sources, entirely different outcomes result. Illustration 7 depicts the issue in a somewhat different way. It overlays each of the individual revenue sources reviewed. It is fairly clear that the aggregation of one or more of the individual revenue sources provides another picture.

Specific proposals thus far made have suggested that the sharing should occur on some kind of per capita basis. As described in the attached revenue sharing report, per capita sharing has a huge bias which assumes that business and commerce require no city services. As argued in that report, the single two most expensive services in literally all cities, namely police and fire, clearly have services to provide to the business and industry sector. Substantial road and bridge systems must be developed to support a

ILLUSTRATION 7
TOTAL REVENUES PER CAPITA



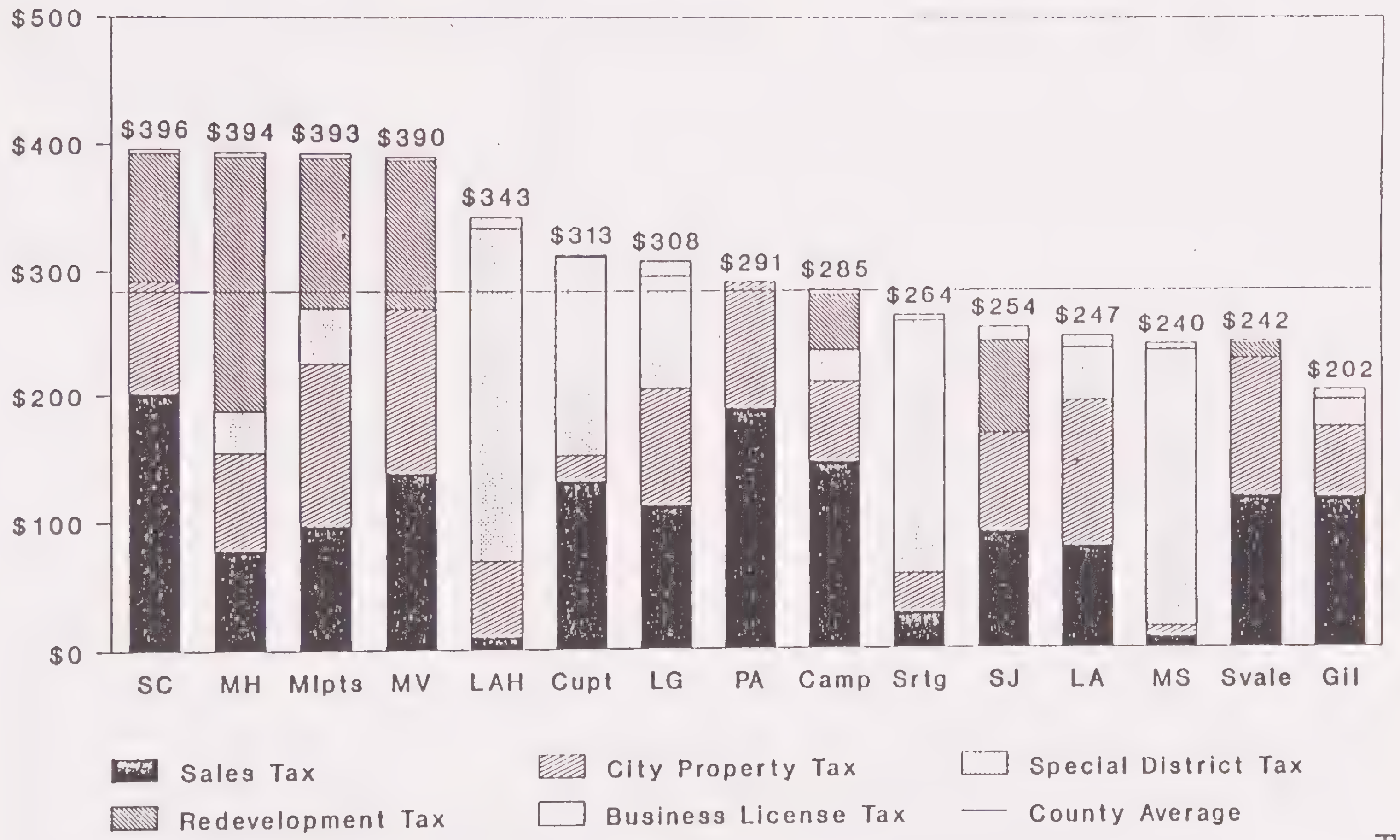
large commercial base. Building safety departments have significantly different and larger demands in communities with a large commercial base. Hazardous waste response, recreation programs, open space requirements, libraries and library business collections, to name just a few, reflect the wide range of city services which must be directed to support a commercial base.

While it is difficult to relate jobs to population, some method must be found to, at minimum, describe the fact that service demands do increase substantially with large commercial bases. For purposes of illustration this report has taken one-fourth of the jobs in each community and added that number to their population bases to demonstrate how demands for services can dramatically change the apparent relationships between one city and another. This is believed to be a very conservative indicator of the municipal service demands created by industrial and commercial development. Illustration 8 graphically depicts the significant changes which result. What that illustration brings even more into question is whether an index based on per capita measures has any logic or legitimacy.

It appears evident from the statistical information generated that no one single per capita revenue measure is a good indicator of a method which would result in any desired outcome regarding growth management. Growth management, while an important issue, should not be construed as an anti-business or anti-jobs issue. Rather, it is an issue of reasonable control that those at a higher level of government may see as needed to protect the quality of life of all in large metropolitan areas. It is not at all clear from the data provided that the presumed financial benefit to be derived from manufacturing and office development necessarily exists. It is clear that the selection of one particular revenue center can frequently have counterproductive, unfair and illogical results. For example, if property tax were selected as the measure, does it make sense for communities who must serve commercial industries to share revenue with residential communities who chose not to have a commercial base? That would be the direct effect of per capita property tax sharing. Does it make sense for cities with commercial industries to share revenue with residential communities where in many cases the total per capita property tax collected within those cities for municipal services is far higher than cities with commercial bases when special district property tax revenues are combined with general property tax revenues? What would be a possible consequence of such a system? The answers could well be that communities which have hosted and invited commercial industries would be far less likely to host them in the future and others who have chosen not to want them would continue that policy because they would receive revenue with no effort and with no change to their community character. In some cases, a consequence could be no growth, as opposed to growth being managed in such a fashion as to maintain local character and rights while not having a negative effect on regional quality of life factors.

ILLUSTRATION 8

TOTAL REVENUES DIVIDED BY POPULATION PLUS 25% OF JOBS



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Further, the property tax per capita approach could have little effect on continued growth within redevelopment project areas. Because there would be no penalty for redevelopment agencies and because other cities may chose to restrict growth, it in fact could encourage even more growth within redevelopment agencies (which is described above as the most powerful and logical relationship to the growth management issue).

Redevelopment, of course, could be singled out as the single source to be dealt with for per capita growth management purposes. Interestingly enough, however, redevelopment seems to have a leveling effect when all the various revenue sources are taken into account.

Further, none of the revenue approaches can account for the differential stages and paces of growth of specific communities. Some are built out, others not. Some have residential areas developed sooner or later than commercial. None of this suggests poor planning -- only reality. Commencing revenue sharing at a particular point in time, however, could have unfair and inequitable consequences due to this factor alone.

The case seems reasonably clear. No individual source of revenue in and of itself is a good measure or a good tool for growth management purposes. As often as not, revenue would be shared with those communities where it would not seem to make sense than where it would seem to make sense. Most important, however, is whether the fundamental question of the relationship between revenue and growth management is answered. Would behaviors change? Would they change in the right way? Most important, are any of these sources individually or in aggregate any reasonable measure of which communities have taken a reasonable approach to growth management both locally and regionally? The answer to that is that no clear conclusion in that regard can be drawn.

Most discussions on the issue of growth and growth management carries an inherent bias that business and commercial development is necessarily negative to quality of life considerations. Clear thinking would obviously conclude that a healthy business environment is critical to any quality of life. **More important, the revenue sharing approach assumes that communities with large commercial and industrial sectors have irresponsible growth policies. That assumption has no basis in fact. While some communities with large business bases may be viewed as placing pressure on regional systems, others could be demonstrated as having responsibly planned in the context of the greater region. They may and often do have the preponderance of multi-family housing, low and moderate income housing, quality transportation systems and the like! In other words, they may have been very responsible to their obligation to the greater region.**

Land use, growth, and tax policies of each city in California is as fundamental to home rule and grass roots democracy as any issue determined at the city level.

Those involved in growth management issues have substantial differences of opinion as to the nature of the problem and its solution. The issue, however, is not revenue nor is the issue land use. This issue is responsible land use decisions at the city level to assure that basic sub-regional and regional systems are not overly negatively impacted by those land use decisions. This being the case, planning itself is the issue, not revenue. A far more direct, useful, and equitable approach would be to develop basic planning standards that all must live within to assure that regional concerns are appropriately dealt with while retaining maximum local control. The Congestion Management Agency requirement recently directed by the State provides one example of this approach. This alternate kind of approach requires 1) a definition of the regional problem; 2) requirements that all must uniformly follow and, 3) penalties, sanctions or remediation for the specific negative effects created.

Attachment: Revenue Sharing at the City Level in California

REVENUE SHARING AT THE CITY LEVEL IN CALIFORNIA

Introduction

Over the past decade a number of proposals have surfaced which would initiate the process of revenue sharing between cities in California. Some of the earlier proposals resulted from the various financial problems of cities, post Proposition 13. Others occurred at various times over the past decade as the budgets of all levels of government came under further stress. There is good reason to believe that the decade of the '90s will be one where revenue sharing proposals receive more serious attention--and in fact, there may be more support from cities who consider themselves "have nots" for such an approach than in the past. Generally speaking, the League of California Cities has remained united over the past decade in opposition to this concept and focused its attention on maintaining financial independence for cities as well as providing greater legislative flexibility for local self determination regarding revenue sources.

The call for revenue sharing at the city level has risen as an approach to different, and largely unrelated, public policy issues. Those issues are:

1. To bring greater equity in funding for city services for cities in California

2. As a means to increase the likelihood that cities will comply with major state policy directions affecting urban California.

3. As a means of discouraging inappropriate land use policies which appear driven by financial reward, often at the sacrifice of a region's quality of life.

The fact that proposals for revenue sharing have occurred as solutions to very different kinds of issues underscores the potential difficulty in constructing a revenue sharing program.

As the remainder of this paper will demonstrate, however, the uniqueness of each city, their needs, and their chosen method of financial support raise serious questions as to whether any revenue sharing method can be constructed which has a reasonable hope of achieving its stated objective. Further, as will be demonstrated, there is a very strong likelihood that a revenue sharing program could well benefit certain cities who do not or should not require such benefit and harm some who arguably should receive assistance if any is to be given.

Understanding Government Structure in California

California, like most other states in the United States, has government services provided by a complex network of various levels of government. It is not the purpose of this paper to explore that structure in any substantial detail. A brief review, however, will differentiate city governments from others, a necessary prerequisite to understanding the revenue sharing issue. The network of government in California is composed of state government, county government, K-12 education governed by school district boards, special districts, and cities.

The only universal unit of government is of course the state. However most state services are not delivered by the state directly. County government exists largely for the purpose of providing at a local level certain state-based services such as courts, welfare, mental health, social services and the like. By no means does this mean that counties provide only state funded and directed services. However, the majority of county services and expenses do fall in this category. Similarly, K-12 education is in fact a state service delivered through local school districts. Those school districts receive overall guidance and standards from the state as to what kind of services they are to provide and, similar to counties, receive a substantial portion of their revenues from the state in the form of per pupil allowances.

Special districts are often difficult to define. They may exist in one geographic area and not in another. The one characteristic of special districts is that they are formed to deliver a specific service in contrast to general purpose municipal government. These districts range in function from providing services such as water wholesaling and flood control to what are generally considered to be specific local government type services such as fire services and libraries. An important characteristic to remember regarding special districts is that in one geographic region their functions might be undertaken either by cities in that area or in some cases by a county, and, in another geographic area, by the special district.

In many respects, city government is the government that has the greatest anomalies compared with all of the other units of government. For the most part, cities provide the services that their constituents have deemed to be important and to the level that they deem necessary without mandate or direction from state level of government and without any financing from state level of government. To be sure, cities have a number of mandated services required by state and federal law, but in almost all circumstances they are required to find the local financing without assistance from the state or federal government. The level of specific mandates, when compared to the entirety of a city

budget is quite small, particularly when compared with county or school district services. Similarly, special districts are very different from cities, given the fact that special districts are exactly that -- they are special in nature with a very limited number of services to be provided and are very limited in terms of the financial sources of support available to them. Cities, on the other hand, are general purpose governments and very frequently provide exactly the same services as a special district may when a city is not a part of nor has chosen to be involved in a special district.

In summary, cities are dramatically different than the other levels of government in California. Each city may have different services provided at different levels based on differing community values, demands and needs. One city might provide all services to its citizens generally provided at the local government level while another may have many services provided to its constituents through totally separate and independent, self funded special districts. Cities which have large job bases provide a different array of services and have a different set of demands placed upon them than cities who, through their land use policies, have chosen to minimize commercial and industrial development. Cities who are found within major metropolitan areas may face substantially different kinds of issues for which they must provide services than do rural communities. There is no effective way to easily compare one city to another, from a service demand perspective, or from a financing perspective, since the purpose for a city's existence is to remain close to its constituency and to design effective service delivery consistent with local, and frequently differing, needs.

Understanding Tax Structures

It is not the purpose of this paper to explore in any detail the financial structures of state, county, or school district finance. As noted earlier, however, sizable sums of school and county budgets derive directly from state taxes which are then provided to these units on a subvention basis for specific services to be provided. This is not the source of financing for city government.

Just as cities have varying levels of services and service needs, it is similarly true that revenue sources differ substantially from one city to the next. This occurs not just because "tax bases" are different, but is directly related to the level and quality of services deemed necessary in a particular community and the taxing policy of the given community. Most cities (but not all) in California derive a significant percentage of their general fund budget from property tax. Cities, however, receive a small percent of property taxes collected, with by far the major portion going to K-12 education and counties. For many cities the next most significant (or most significant) source of revenue is the sales tax; however, in order to garner sales tax the city must allow retail enterprise -- which some cities do not permit to any degree because of their own individual land use

policies. After these two sources of revenue, however, the approach being taken by individual cities is varied and substantially different. Some cities place a premium on user fees to pay for certain services; other cities do not. Some cities have significant business based taxes and others do not. The choice of having high level business taxes does not rest solely on whether a community has a business tax base. Some who do have a business tax base make little or no use of business taxes. Some cities have utility users taxes and others do not and the range of taxes placed on utilities varies dramatically from one city to another. Some cities levy transient occupancy taxes (a room tax on hotels and motels), others do not. Similar to the utility users tax, the range of these taxes vary substantially. Some cities place a tax on admissions to entertainment activities while others do not.

Taxing policies also can become locked in. An example is the property tax. Prior to 1978, cities and counties as well as school districts could levy a property tax at a rate they considered to be appropriate. When Proposition 13 was passed, it not only rolled the property tax back by two-thirds, but it also established a new apportionment system. After aggregate property taxes for any property tax payer were rolled back to no more than one percent of market value of property, a method had to be established by state government to assure that all local governments when combined together would not exceed the constitutional one percent limit. This was done by the state legislating that after the rollback occurred, the percentage of property tax that any particular unit of government would receive in the future must be the same percent which they received in the year previous to Proposition 13. If a city, at the time of enactment of Prop 13, was receiving 15% of the property tax, the county 35% and education 60% -- that percentage would remain fixed at that level each year thereafter. Prior to Proposition 13, property tax rates at the city level varied for several public policy reasons. For example, one community might have had a very low property tax rate but generated a substantial amount of property tax because it had a large business base. Another community might have a low property tax rate because it had a high yield in revenues from other sources such as sales tax, business taxes, or TOT taxes.

The one universal characteristic of tax structures at the local level is that one could not look at the per capita revenues generated for any one particular tax source and come to any conclusion as to the overall level of tax effort that particular community has; nor the level of service demands within that particular community which need to be supported with available revenues.

<u>Dilemmas of Revenue Sharing at the Local Level</u>

When the issue of revenue sharing for local government is addressed, as noted in the introductory section, three major policy goals are often expressed as the objective for that

revenue sharing. Two of those goals, growth management and compliance with statewide or regional policies, do not require revenue sharing for their implementation nor is revenue sharing necessarily the best policy choice available to ensure compliance. To be sure, when a higher level authority has established statewide public policy, it is important to also establish methods to assure that the established public policy is undertaken. It is not this paper's intent to explore the issues of regional government, statewide housing goals or the like. It is important to dispense with the notion, however, that revenue sharing is a tool that should be connected to these efforts as the most reasonable approach to assure compliance. For example, legislation forming the congestion management agencies in urban areas throughout California took the approach of revenue sanctions for failure to act as opposed to generic revenue sharing. Many different forms of sanctions, some of them very powerful, can be established to assure that public policy objectives are met. In the case of the CMA, the State Legislature made the choice of withholding new gas tax funds for failure to comply. This sanction step could be taken substantially further, for example, by withholding existing gas taxes as well.

The important point, however, is that a sanction does not need to deal with issues of revenue equity. It's purpose is to gain compliance with a higher level of government's aim. One of the reasons that it is argued that regional government connected with revenue sharing is necessary is for the explicit purpose of growth management. In this instance, steps without resort to revenue sharing could be established which would be more powerful than any kind of revenue sharing proposal and which would better achieve the policy purpose. For example, there are metropolitan areas which have developed region-wide plans and insist that all local land use plans be compatible with them. This step alone would go much further toward accomplishing the policy purpose than a revenue sharing approach. Further, the sanction approach as used with CMA's could also be applied to any growth management proposal.

The last purpose for revenue sharing, as noted in the introduction, equity, is then one worthy of further focus as the only objective reasonably linked to this concept.

The first issue to be addressed regarding the equity question is the standard that would be used to judge what equity means. Following is a review of several implicit assumptions being made as various revenue sharing options have been proposed, and some difficulties with each.

1. Assumption: expenditure requirements, and therefore revenue requirements are directly related to the population of a particular city.

Most revenue sharing proposals to date focus on per capita distribution of property tax or sales tax as opposed to their present situs based distribution. Often these proposals suggest sharing on a per capita basis of the growth increment. Such an approach assumes that population is the major determinant in a city's expenditure requirement. This assumption is simplistic and incorrect for several reasons.

a. As described above, each city has a very different constituency. A city, by its own choice, which allows substantial industrial and commercial development, must dedicate a significant portion of its budget to provide service to that component -- well beyond the services that would otherwise be provided if a community was residential only. For example, a substantial amount of the road system in any city is dependent upon volumes of travel that exist. If a community has a substantial business and industrial base, not only are roads built to service the residential population but the commercial population as well. Frequently there are oversized thoroughfares, expensive grade separations, and more sophisticated traffic signal devices, etc. which must be built and maintained. Fire services in communities with business bases must be substantially more sophisticated in terms of equipment, training and personnel than in a residentially dominated community. In larger communities, several fire stations may be solely dedicated to protection of commercial and industrial properties as well as specialized apparatus, hazardous material units and the like. Law enforcement services differ substantially in communities with business bases from those required by communities which are primarily residential. Specialized investigative units are required as well as different patrol deployment and enhanced deployment to handle both traffic and law enforcement needs. Other services are also affected such as planning, building, libraries and park and recreation services. The point is that communities with sizable commercial and industrial components also have very different requirements for the services provided and therefore have different revenue and expenditure profiles. Per capita property and sales tax revenues are likely to be higher when there is a greater amount of commercial and industrial development. For reason noted above, however, such a community could as easily be a "have not" as a "have," given that per capita revenues have little relation to expenditure demands.

b. The argument that per capita distribution solves the equity issues is further refuted when the complexities of local government is added as a variable. For example, one community may have fire services provided by independent and separately financed special districts with no connection to

that particular city, and yet that city may collect property taxes and sales taxes in exactly the same fashion as a city which provides those services directly as a part of its tax base. California is replete with these kinds of examples that some would argue already place certain cities in an advantageous position regarding the revenue and expenditure stream, since the revenue options remain the same as for any other city but expenditures are dramatically reduced because special self-funded districts provide some of the services.

2. Assumption: per capita property or sales taxes are a good means for revenue sharing.

This assumption is predicated on the belief that these tax sources are the best selection for revenue sharing because they are reasonably uniform taxes to the consumer (though not for recipient government agencies). The fact is that they are for all practical purposes the only major tax sources that can be tapped because other city tax sources are locally established and collected. As a result, they become the only likely choice.

The arguments in (1) above demonstrate why a per capita measure is not a reliable measure of need. Additionally, however, because cities have selected revenue strategies based on their own local conditions, an approach such as general revenue sharing around per capita sales tax could well create greater inequities than it would solve. If a community chose a low property tax structure over a decade ago and instead relied, and relies, on sales taxes, to take a portion of sales taxes away could have a devastating effect. There are no-property tax cities in California which are now largely locked into that fate due to Proposition 13. They instead built a revenue base largely reliant on sales tax and the businesses that provide sales tax, and they may have very little opportunity with other taxes available to replace the revenue lost. Sharing of sales tax revenue treats all high and low sales tax cities similarly, regardless of the circumstances which led to either a high or low per capita sales tax. Further, as noted earlier within this paper, there are communities which as a matter of land use policy have chosen to have little or no commercial base and therefore derive literally no sales tax. There are other cities who have attempted to gain a sales tax base but have been less successful and it could be argued that they require the additional revenue. Because situations on absolute opposite extremes are present, both would benefit from a sales tax sharing, one community arguably in need and the other, not.

Even more problematic is the notion of property tax sharing. It is important to note that the majority of property taxes do not go to cities, with by far the largest proportion being distributed to counties and schools. The presumed revenue incentive for cities for property tax growth is much less than is generally assumed. Property taxes were instituted for the purpose of providing local government services. For many cities, the property tax is the major source of revenue. Many communities which have a large commercial and industrial sector to serve may have a high per capita property tax but also a high service demand, as noted earlier. Other communities could have a low per capita property tax largely on the basis that they have elected to not have a considerable industrial and/or commercial land use in their communities, but these communities also do not have to provide city services to such elements of their community. Per capita sharing of property tax then could, and would, have the effect in many instances of rewarding those not in need at the sacrifice of those who do require the revenue. Property taxes are particularly interesting given that, in this area, property taxes also go to support special districts such as library districts and fire districts as well as being intimately tied to redevelopment agencies. Property tax sharing on a per capita basis could result in sharing revenue to a community which, when its own property tax revenue is combined with the property tax revenues going to support a fire and library district independent of that particular city but serving the same residents is greater than the per capita property tax of a full service city.

Redevelopment agencies can dramatically change the scheme of property tax sharing. A given city which has a sizable redevelopment agency can literally be funneling 100% of available property tax increments back into redevelopment agency (city) coffers. Where redevelopment exist, 100% of any property tax gains occurring through redevelopment go to that city and are not distributed to county and school agencies. Much of the use of redevelopment revenue is for improvements that a city would otherwise provide through normal revenue sources if available. Therefore to not take into account the effects of redevelopment on property tax could again be rewarding those that de facto have substantially more property tax income than others do even though others appear to have more based on calculations which do not include redevelopment revenues. If there is an incentive for growth of property tax revenue, it is in redevelopment areas, since 100% of the increment is captured.

3. Assumption: per capita expenditures form a good basis to establish need.

A final method to establish need is to analyze expenditures as opposed to any particular source of revenue. A complex scheme would have to be established to determine from what source of money revenues would be shared, but the basis

of sharing would not be per capita revenue generation but rather per capita expenditure. Establishing an equitable approach to per capita expenditures would have many of the same dilemmas and problems alluded to above. Cities do different things. Some provide all services, others have services provided by special districts, which they do not control. Some have extensive commercial bases to serve, others do not. Additionally, cities are at dramatically different levels of efficiency in service provision. Use of a simple expenditure per capita approach assumes all cities' demand for services, needs for services, and efficiency in providing services are the same.

4. Assumption: other local revenue sources are unimportant in determining a revenue sharing method.

   No proposal has yet been made (and it would be highly questionable whether it legally could work) that cities share other forms of locally generated revenue such as business taxes, transient occupancy taxes, utility taxes, amusement taxes and the like. City practices throughout California vary dramatically in this area, presumably on the basis of local need and the political acceptance of various methods of taxation. Because many full service cities rely heavily on these sources, however, they are not immaterial to the analysis. To not recognize their existence may again result in unintended and opposite results. It could and would result in communities who have not had the political will to use their own broad taxing authority locally to receive revenues from those that have.

Conclusion:

The revenue needs of all local governments are real. Well intentioned proposals to deal with revenue sharing do not and could not possibly fairly address the issue given the incredible diversity and complexity of city government. Even if a new state-wide tax source was found to share back with cities in need, it is clear that establishing need would be a complex task and one destined to provide little assistance to certain communities who may well be in need and substantial sums to others with no need.

This dilemma should not be at all surprising once the essence of city government is truly understood. It is the city level of government which exists for and by the community it serves uniquely organized with unique revenue and expenditure patterns based on locally determined conditions.

APPENDIX A
THE REVENUE SHARING GAME
COMPUTATIONAL EXAMPLES

	City A	City B	City C	City D
1) Type	Urban Full Service	Residential Not Full Service	Urban Full Service	Urban Limited Service
2) Residents	100,000	100,000	100,000	100,000
3) Jobs	50,000	0	50,000	50,000
4) Residential Assessed Value	$2.5 Billion	$2.5 Billion	$2.5 Billion	$ 2.5 Billion
5) Commercial Assessed Value	$2.5 Billion	0	$2.5 Billion	$2.5 Billion
6) Property Tax % Total Collected *	10%	20%	10%	5%
7) Total Property Tax Collected	$50,000,000	$25,000,000	$50,000,000	$50,000,000
8) City Share	$5,000,000	$5,000,000	$5,000,000	$2,500,000
9) Per Capita Property Tax	$50	$50	$50	$25
10) Sales Tax	$10,000,000	0	$5,000,000	$20,000,000
11) Per Capita Sales Tax	$100	0	$50	$200
12) Redevelopment	0	0	$5,000,000 or $50/Capita	$5,000,000 or $50/Capita
13) Special Districts	0	2-Library & Fire Combined Receive $25/Capita*	0	2-Combined Receive $25/Capita*

*Please note individual tax payers pay 1% of property value regardless of city share.

ANALYSIS OF CITY EXAMPLES

The foregoing provides an example of the dilemmas implicit in city revenue sharing. To assist in thinking about the examples, some questions might help.

1. Which city is likely to have the greatest service demand?
   All things being equal, cities A and C, as they have similar mixes of residential and commercial to serve. They would be followed by D and B in that order since neither of these cities have to provide library or fire services, but D does have a commercial base to serve.

2. Do A and C really have the same demands?
   The reader might want to contemplate whether, if A had twice the crime rate of C, or if C's infrastructure was 75 years old and A's 25, what the answer might be. Obviously, there are an infinite number of service variables which should be considered in defining need.

3. Which city, all things being equal, appears to need revenue the most? The least?
   The answer depends on a lot of assumptions. Let's assume a per capita property tax sharing arrangement. On this basis, City D clearly is the most in need and all others are equal with D receiving $25 per capita and the rest, $50. Yet with only one consideration, that being that certain services in D and B are not provided or funded by the respective city but a self-governing and self-funded special district, the picture changes dramatically. Now City B goes to first with $75/capita and A, C and D are at $50.

   How about redevelopment? By adding redevelopment revenue, the picture changes again. City D now moves into the lead with $100/capita along with C; B is second at $75 and A is last with $50.

4. So What?
   Huge transfers of money could occur based on simple assumptions that don't stand up. Notice, need has really not been established. By considering other property tax revenues that an agency receives like redevelopment and services presumed need changes substantially.

5. What about sales tax?
   On a sales tax basis, the clear winner is D. That's probably why they levied pre-Proposition 13 such a low proportionate property tax (5%). A has the second highest, then C, and finally B -- because it doesn't allow commercial development.

6. So who should share with whom on this basis?
Clearly, B takes and C gives, even though C has a considerable commercial base to serve and B has none.

7. That doesn't seem to make sense because under 3) above, B came out in the best shape. How can it be the worst and best at the same time? It can't! It's the result of mathematical calculations done in isolation regarding how you establish need.

8. Why not combine property tax and sales tax? Okay, let's try it. The descending per capita order is as follows:

(1)	D	$225/capita
(2)	A	$150/capita
(3)	C	$100/capita
(4)	B	$ 50/capita

Now we're getting somewhere. Clearly D is the fat cat and B is in poverty. Well, maybe. Let's add the special districts to get:

(1)	D	$250/capita
(2)	A	$150/capita
(3)	C	$100/capita
(4)	D	$ 75/capita

Wait a minute! What about redevelopment? Let's put that in. Now it looks like:

(1)	D	$300/capita
(2)	C	$150/capita
(3)	A	$150/capita
(4)	B	$ 75/capita

9. So what does all of this mean? The answer is -- nothing. Clearly all of the variables used are very relevant to any formula. Depending on which are used and which are not, results can be <u>radically</u> different. In addition, <u>no</u> variables have been added regarding other revenues collected. It is possible and likely, if they are, that the rankings would again change. And what abut need? We know no more than when we started. We have no knowledge on age of community, ethnic composition, income levels, crime rates, age of structures, education levels, type of industry -- a few of the critical variables that determine need. We don't know

anything about efficiencies of local services or the differences in what each community has determined it wishes for itself.

The only thing we know for sure is that a revenue sharing approach could well take from the most needy and give to the least!